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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. [illegible]

J. G. BOSWELL COMPANY and J. G. BOSWELL COMPANY (successor by merger to Tulare Lake Land Company),

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

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SUBJECT INDEX

	PAGE
Opinions below	2
Grounds upon which jurisdiction of this court is invoked	2
Question presented for review	2
Statutes and regulations involved	3
Statement of the case	7
Jurisdiction of the Tax Court and the United States Court of Appeals for the Ninth Circuit	10
Reasons for granting the writ	11
1. The Circuit Court of Appeals has rendered a decision in conflict with applicable decisions of this court	11
2. The Circuit Court of Appeals below has rendered a decision in conflict with the decisions of other Circuit Courts of Appeal on the same matter	13
3. The court below in holding that this court's decision in Hort v. Commissioner, 313 U. S. 28, is controlling, reached a decision in conflict with statutory provisions and in conflict with the decision of this court in the Hort case itself	14
Conclusion	19
Appendix:	
Opinion of the United States Court of Appeals for the Ninth Circuit	App. p. 1
Judgment	App. p. 12

TABLE OF AUTHORITIES CITED

Cases	PAGE
Alcoma Association, Inc. v. United States, 239 F. 2d 365	14
Bonwit Teller & Co. v. Commissioner, 53 F. 2d 381, cert. den. 284 U. S. 690	16
Farmer's Appeal, 1 B. T. A. 711	15
Farmers and Merchants Bank of Catlettsburg, 59 F. 2d 912	18
Ferguson v. Commissioner, 59 F. 2d 893	14
Helvering v. Owens, 305 U. S. 468	11
Hort v. Commissioner, 313 U. S. 28	14, 15, 16
Josey v. Commissioner, 104 F. 2d 453	17
Maass v. Higgins, 312 U. S. 443	15
Moore, Mary Young, 207 Fed. 265, cert. den. 347 U. S. 942	16
Pollack v. Farmers' Loan and Trust Company, 157 U. S. 429	11
Portsmouth Harbor Land and Hotel Company v. United States, 260 U. S. 327	13
Pumpelly v. Greenbay and Mississippi Canal Company, 13 Wall. (U. S. 166) 20 L. Ed. 577	11
Raytheon Production Corporation v. Commissioner, 144 F. 2d 110	18
Rhodes v. Commissioner, 100 F. 2d 966	14
Shearer v. Anderson, 16 F. 2d 995	14
United States v. Causby, 328 U. S. 256	13
United States v. Grizzard, 219 U. S. 180	12
United States v. Lynah, 188 U. S. 445	12, 13
United States v. Welch, 217 U. S. 333	12
United States v. White Dental Manufacturing Company, 274 U. S. 398	11
Warren Service Corp. v. Commissioner, 110 F. 2d 723	17

REGULATIONS PAGE

Regulation 111, Sec. 1.165-7 5

Regulation 111, Sec. 1.165-7(e) 5

Regulation 111, Sec. 29.23(e)(i) 3

Regulation 111, Sec. 29.23(e)(5) 4

Regulation 111, Sec. 29.23(f)(1) 3

STATUTES

Internal Revenue Code of 1939, Sec. 23(f) 3

Internal Revenue Code of 1939, Sec. 23(k) 16

Internal Revenue Code of 1939, Sec. 44(d) 16

Internal Revenue Code of 1939, Sec. 113(a) 16

Internal Revenue Code of 1939, Sec. 117(j) 6, 19

Internal Revenue Code, Sec. 6213(A) 10

Internal Revenue Code, Sec. 7442 10

Internal Revenue Code, Sec. 7482 10

United States Code, Title 28, Sec. 1254(1) 2

United States Code, Title 28, Sec. 2101(c) 2

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vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI.

To the Supreme Court of the United States:

Petitioner respectfully prays for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit to review a judgment thereof holding that petitioner did not sustain a loss deductible for income tax purposes from a flood occurring in the spring of 1952 which inundated its farming lands by 13 feet of water which it was correctly estimated would remain on the lands and prevent their use for one and two years, respectively.

Opinions Below.

This case was tried in the Tax Court of the United States and in its decision reported in 34 T. C. 539 (1960) it held that petitioner was not entitled to deduct for income tax purposes losses caused by said flood.

The decision of the Tax Court was appealed to the United States Court of Appeals for the Ninth Circuit, which, on April 17, 1962, affirmed the Tax Court's decision.

The later decision has not been officially reported, but is found in the appendix to this petition.

The judgment of the United States Circuit Court of Appeals, the court below said:

"The decision of the Tax Court is affirmed."

(See Appendix.)

Grounds Upon Which Jurisdiction of This Court Is Invoked.

1. The judgment of the United States Court of Appeals for the Ninth Circuit here sought to be reviewed was rendered and entered April 17, 1962.

2. The statutory provisions which confer jurisdiction to review the judgment in question by Writ of Certiorari are 28 United States Code, Sections 1254(1) and 2101(c).

Question Presented for Review.

Whether petitioner suffered losses deductible for income tax purposes in its fiscal year ended June 30, 1952 for certain properties, and in its fiscal year ended March 31, 1953 for other properties, due to a flood coming upon petitioner's farming lands in the spring of 1952,

which flood had reached its height by June 30, 1952, by which time it was ascertainable that petitioner's farming lands (lying in an undrainable basin) would be under water and unusable for one and two years, respectively.

Statutes and Regulations Involved.

Section 23(f) of the Internal Revenue Code of 1939 in effect for 1952 and 1953, provided for losses by corporations as follows:

> "In the case of a corporation, losses sustained during the taxable year and not compensated for by insurance or otherwise."

Regulation 111, Section 29.23(f)(1) in effect until September 1953 read as follows:

> "Losses by corporations—Losses sustained by domestic corporations during the taxable year and not compensated for by insurance, or otherwise are deductible * * *. The provisions of Section 29.23(e)(1) to 29.23(e)(5), inclusive, and Section 29.23(i)(1) are in general applicable to corporations as well as individuals. * * *"

Section 29.23(e)(i) of Regulation 111 pertains to losses by individuals. To the extent that it is applicable it is here quoted:

> "Losses sustained by individual citizens or residents of the United States and not compensated for by insurance or otherwise are fully deductible if—
>
> (a) incurred in the taxpayer's trade or business, or

(b) incurred in any transaction entered into for profit, or

(c) arising from fires, storms, shipwreck, or other casualty, or theft, and a deduction therefor has not prior to the filing of the return been claimed for estate tax purposes in the estate tax return, or

(d) if not prohibited or limited by any of the following sections of the Internal Revenue Code: Sections 23(g) and 117, relating to capital losses; Section 23(h) relating to wagering losses; Section 24(b) relating to losses from sales or exchanges of of property between persons designated therein; Section 112, relating to recognition of gain or loss upon sales or exchange of properties: Section 118, relating to losses on wash sales of stock or securities: * * *"

"In general losses for which an amount may be deducted from gross income must be evidenced by a closed and completed transaction, fixed by identifiable events, bona fide and actually sustained during the taxable period for which allowed. Substance and not mere form will govern in determining deductible losses. Full consideration must be given to any salvage value and to any insurance or other compensation received in determining the amount of losses actually sustained. See section 113(b) * * *".

Section 20.23(e)(5) covers losses of farmers and that regulation will be quoted in such parts as is considered applicable as follows:

"Losses incurred in the operation of farms as business enterprises are deductible from gross income. * * *"

Regulation 111-Section 1.165-7 Casualty Losses.

b. Amount deductible—General Rule. In the case of any casualty loss, whether or not incurred in a trade or business or in any transaction entered into for profit, the amount of loss to be taken into account for purposes of Section 165(a) shall be the lesser of either—(i) the amount which is equal to the fair market value of the property immediately before the casualty reduced by the fair market value of the property immediately after the casualty; or (ii) the amount of the adjusted basis prescribed in Section 1.1011-1 for determining the loss from the sale or other disposition of the property involved."

Subsection (e) of that section prescribed the effective date of that amendment to the regulations covering losses as follows:

"(e) Effective date. The rules of this section are applicable to any taxable year beginning after the date of the publication of this section in the Federal Register as a Treasury decision. If, for any taxable year beginning on or before such date, a taxpayer computed the amount of any casualty loss in accordance with the rules then applicable, such taxpayer is not required to change the amount of the casualty loss allowable for any such prior taxable tax year. On the other hand, the taxpayer may, if he so desires, amend his income tax return for such year to compute the amount of a casualty

loss in accordance with the provisions of this section, but no provision in this section shall be construed as extending the period of limitations within which a claim for credit or refund may be filed under Section 6511."

Section 117(j) of the Internal Revenue Code of 1939 in effect for 1952 and 1953 read in part as follows:

"117(j). Gains and losses from involuntary conversion and from the sale or exchange of certain property used in the trade or business.

(1) Definition of Property Used in the Trade or Business.—For the purposes of this subsection, the term 'property used in the trade or business' means property used in the trade or business, of a character which is subject to the allowance for depreciation provided in Section 23(1), held for more than 6 months, and real property used in the trade or business held for more than 6 months, which is not (A) property of a kind which would properly be includable in the inventory of the taxpayer if on hand at the close of the taxable year, or (B) property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business. * * *

(2) General Rule.—If, during the taxable year, the recognized gains upon sales or exchanges of property used in the trade or business, plus the recognized gains from the compulsory or involuntary conversion (as a result of destruction in whole or in part, theft or seizure, or an exercise of the power of requisition or condemnation or the threat or imminence thereof) of property used in the

trade or business and capital assets held for more than 6 months into other property or money, exceed the recognized losses from such sales, exchanges, and conversions, such gains and losses shall be considered as gains and losses from sales or exchanges of capital assets held for more than six months. If such gains do not exceed such losses, such gains and losses shall not be considered as gains and losses from sales or exchanges of capital assets. For the purposes of this paragraph: * * * (B) Losses upon the destruction, in whole or in part, theft or seizure, or requisition or condemnation of property used in the trade or business or capital assets held for more than 6 months shall be considered losses from a compulsory or involuntary conversion."

Statement of the Case.

Petitioner, J. G. Boswell Company, is a California corporation, and is a successor by merger in 1957, of the Tulare Lake Land Company and the J. G. Boswell Company. The predecessor companies both owned lands in Tulare Lake Basin which was inundated by the flood. Because they had different fiscal years at the time of the flood, the loss deductions claimed appear in two separate tax periods. The losses of the original Boswell Company occurred in the fiscal year ended June 30, 1952 and the losses of the old Tulare Lake Land Company occurred in the fiscal year ended March 31, 1953. (Appendix, p. 2.)

During the taxable years in question, the petitioner was engaged in the operation of farms in Kings County,

California in an area commonly known as Tulare Lake Basin. (Appendix, p. 2.)

The lowest natural outlet is nearly 30 feet above the floor of the basin, so the flooding waters settle and in time sink into the soil to some extent, evaporate, or are removed by pumping. Approximately four feet below the surface is a hard clay pan which, for all practical purposes is impervious to water, hence, there is not much absorption of flood water by the soil. (Appendix, p. 3.)

The levees surrounding petitioner's lands were breached in the spring of 1952, and by June 30, 1952 when the flood reached its crest, all the lands in question were covered with 12 to 15 feet of water. The lands could not be used for any purpose until the water was cleared therefrom. (Appendix, pp. 4, 6.) It was determinable, as of June 30, 1952, that the lands could not be cleared of water, or used, for one and two years, respectively, depending upon the height of their protecting levees. (Appendix, pp. 6, 7.)

Pumping of the flood waters off some of the parcels owned by the two companies was completed February 23, 1953. (Appendix, p. 4.)

Pumping of the waters off the other areas owned by both companies was completed by September 22, 1953. (Appendix, p. 5.)

The values and rental values of the lands prior to the flood were high. [Tr. 56, 293.] Petitioners received

no insurance or other type of compensation for damages from this flood. [Tr. 98.]

The United States Circuit Court of Appeals did not find which date was "immediately after the flood", nor the value of the lands "immediately after the flood". (Appendix.)

Both the Tax Court and the United States Circuit Court of Appeals found that a loss from the flood, if any, was clearly "that of petitioner" and that "the flood constituted an identifiable event fixing the onset of the alleged damage, if any". (Appendix, p. 5.)

These findings left for determination the other elements of loss which the Tax Court and the Circuit Court of Appeals found were elements necessary to a loss. These were as follows:

1. There must be an actual loss.

2. The loss must be evidenced by a closed and completed transaction, and

3. The loss must be sustained in the year claimed as a deduction. (Appendix p. 5.)

Both the Tax Court and the Circuit Court of Appeals found against the petitioner on the first two of these three elements, and by implication, on the third element. (Appendix, pp. 6-8.)

In the Tax Court and in the Court of Appeals, the taxpayer claimed four types of losses which are set out on page 2 of the Appendix. In this Court the petitioner claims only the first type; namely, that it had

a loss of capital, as it would lose the use of its land for a period of time—that is, as long as the land remained under water.

Petitioner claimed in the Tax Court and in the Circuit Court of Appeals, and claims in this Court that petitioner's inability to use its farming lands because of the water standing there on, constituted a final and nonrecoverable and nonreversible impairment to the value of the land which entitled petitioner to a deduction for loss of present capital.

Both the Tax Court and the Court of Appeals held that this was not a loss of present capital caused by a casualty but was merely a prospective loss of potential income. Both Courts also then went on to say that the prospective loss of use was too temporary to be considered a closed transaction or a loss of present capital, which were prerequisites to a deductible loss.

Petitioner maintains that the *duration* of the loss of use affected the amount of the damage or shrinkage in the value of the land *only*, and not the critical question of whether there was a closed transaction—a loss of present capital.

Jurisdiction of the Tax Court and the United States Court of Appeals for the Ninth Circuit.

This case came before the Circuit Court of Appeals under the provisions of Section 7482 of the Internal Revenue Code on a petition for review of a decision and order of the Tax Court of the United States which took jurisdiction under the provisions of Section 7442 and 6213(A) of the Internal Revenue Code.

REASONS FOR GRANTING THE WRIT.

1. The Circuit Court of Appeals Has Rendered a Decision in Conflict With Applicable Decisions of This Court.

The Circuit Court of Appeals in the instant case held that the impairment of the future use of the property by a casualty did not cause a present loss of capital and was not a closed and completed transaction. That principle conflicts with decisions of this Court.

In the following tax cases this Court held that injuries to property or the use of property, which did not completely destroy the property, constituted closed and completed transactions and losses of present capital: *United States v. White Dental Manufacturing Company*, 274 U. S. 398 (where the use of the property was lost by seizure by the German Government in the First World War but was recovered two years later); *Helvering v. Owens*, 305 U. S. 468 (where a car was merely damaged in the amount of $35 by a collision).

The decision of the court below that the flood did not cause a loss of present capital is contrary to many decisions and contrary to principles of law heretofore propounded by this Court. In *Pollack v. Farmers Loan and Trust Company*, 157 U. S. 429, this Court on page 693, said:

> "It must be conceded that whatever affects any element that gives an article its value, in the eye of the law, affects the article itself."

This principle has been recognized by this Court in several non-tax cases of injury to the use of property. For example, in *Pumpelly v. Greenbay and Mississippi Canal Company*, 13 Wall. (U. S. 166, 20 L. Ed. 577),

this Court held that the government had "condemned" 600 acres of farming land and must pay the property owner for it, when it erected a dam across the Fox River, which was an outlet of Lake Winnebayo, by which the water of the lake was raised so high as to flood the land and to do the damage complained of. This Court held that the water standing on the land almost completely destroyed the value of the land. This Court at page 181 said:

> ". . . it remains true that where real estate is actually invaded by superinduced additions of water, earth, sand or other material, or by having any artificial structure placed on it, so as to effectually destroy or impair its usefulness, it is a taking, within the meaning of the Constitution, and that this proposition is not in conflict with the weight of judicial authority in this country, and certainly not with sound principle."

Also, on page 179, this Court said:

> "But there are numerous authorities to sustain the doctrine that a serious interruption to the common and necessary use of property may be, in the language of Mr. Angell in his work on watercourses, equivalent to the taking of it, and that under the Constitutional provisions it is not necessary that the land should be absolutely taken."

Similar cases involving flooding of land are *United States v. Welch*, 217 U. S. 333 (1910); *United States v. Grizzard*, 219 U. S. 180 (1911); *United States v. Lynah*, 188 U. S. 445 (1903).

In *United States v. Lynah, supra*, on page 470, this Court said:

> "While the government does not directly proceed to appropriate the title, yet it takes away the use and value; when that is done it is of little consequence in whom the fee may be vested."

In more recent nontax cases not involving flooding but otherwise involving injury to the use of land, this Court held that the government had "taken" property and was required to pay for it. See *United States v. Causby*, 328 U. S. 256, where the government flew aircraft over land, which destroyed its use; *Portsmouth Harbor Land and Hotel Company v. U. S.*, 260 U. S. 327 where the government fired guns over the land which destroyed its use.

In holding that there was no present loss of capital caused by the flood the court below reached a decision in conflict with the above-mentioned nontax decisions of this Court; namely, that injury to the use of the property is a partial destruction of the capital in the property itself. In reaching the decision that there was not a closed and completed transaction caused by the flood the court below has reached a decision in conflict with the decisions of this Court in tax cases that a casualty doing an injury to property or the use of property, is a closed and completed transaction.

2. The Circuit Court of Appeals Below Has Rendered a Decision in Conflict With the Decisions of Other Circuit Courts of Appeal on the Same Matter.

Other Circuit Courts of Appeal, in cases involving injuries to property from casualties have decided that

there were closed and completed transactions and losses of present capital, which formed the basis for losses for income tax purposes. See *Shearer v. Anderson* (C. A. 2), 16 F. 2d 995 (where an auto was injured, but not destroyed, on an icy road); *Ferguson v. Commissioner* (C. A. 10), 59 F. 2d 893 (where farmland was injured by a flood---type of injury not described); *Rhodes v. Commissioner* (C. A. 6), 100 F. 2d 966 (where land was covered with sand and debris by a hurricane but was sold the next year); *Alcoma Association, Incorporated v. U. S.* (C. A. 5), 239 F. 2d 365 (where a hurricane damaged some but not all of the citrus trees in a grove).

The statute does not require the damage to be total or perpetual or even permanent. The duration of the damage affects only the amount of the loss, and does not determine the critical question of whether there was a closed and completed transaction, and a loss of present capital.

While the impairment to use of lands in the case at bar may not have been perpetual, the loss was permanent.

3. The Court Below in Holding That This Court's Decision in Hort v. Commissioner, 313 U. S. 28, Is Controlling, Reached a Decision in Conflict With Statutory Provisions and in Conflict With the Decision of This Court in the Hort Case Itself.

In the *Hort* case, *supra*, this Court, in holding that the taxpayer did not have a deductible loss when it permitted the cancellation of a lease upon the receipt of $140,000, page 31, said:

"For the same reasons, that amount was not a return of capital because petitioner acquired the lease as an incident of the realty devised to him by his father. Theoretically, it might have been possible in such a case to value realty and lease separately and to label each a capital asset. Compare *Maass v. Higgins*, 312 U. S. 443; Farmer's Appeal, 1 B. T. A. 711. * * *"

The *Maass v. Higgins* and *Farmer* cases involved situations where separate values for leases had not been ascertained.

In the *Hort* case, the Tax Court, in its Opinion 39 B. T. A. 922 said:

"The petitioner has failed to prove any figures from which a loss can be computed. A loss from the disposition of property is computed for income tax purposes by deducting the amount realized from the adjusted basis. The amount realized from the cancellation of the lease was $140,000.

"This lease cost the petitioner nothing and we must assume, in accordance with Commissioner's determination, that it had no basis in his hands for gain or loss. * * *"

The above quoted language of this Court, therefore, implies that if the lease had a basis in the hands of Hort he might have had a deductible loss, even though he did not sell it, but merely collected less on it than he might have done if it had not been cancelled.

There are cases in which leaseholds owned by lessors had separate basis which could be amortized or made the basis for losses. See *Mary Young Moore*,

207 Fed. 265 (C. A. 9), cert. denied, 347 U. S. 942, and *Bowcit Teller & Co. v. Commissioner*, 53 F. 2d 381 (C. A. 2), cert. denied 284 U. S. 690.

Under Section 23(k), Internal Revenue Code of 1939, a taxpayer was permitted to deduct bad debts where the taxpayer had a basis for the accounts receivable. Said basis was described in Section 113(a) of said Code.

Also by Section 44(d), 1939 Code, a taxpayer could take a deduction upon disposition of an installment obligation if it received less than the basis, which basis was set out in Section 44(d).

Consequently, in those cases where a taxpayer had a basis for an account receivable, an installment obligation, or a lease, and disposed of them for less than its cost, it could have a deduction. Obviously, the taxpayer would expect to receive at least its cost and perhaps more. Hence, under certain circumstances, a taxpayer may take a loss when it disposes of an asset for less than it expects to receive.

In the *Hort* case, therefore, the taxpayer simply had no basis for the lease and obviously could deduct nothing when it cancelled the lease for a certain amount of money.

The petitioner in the case at bar, of course, had a basis for the land which was injured. [Tr. 49.] It can deduct the shrinkage in the value of the property, not in excess of its cost, where caused by a casualty.

The matter of cost of the lease in the *Hort* case was really the controlling point. In all of the cases leading up to it, the lack of cost for the leases was the determining factor. For instance, in *Warren Service*

Corp. v. Commissioner, 110 F. 2d 723 (C. A. 2), the court, page 724, said:

> "The Board made no finding that any part of the sum expended by the taxpayer was invested in the lease and the evidence would not have justified such a finding. Nothing was set up on the books of the taxpayer as an investment in the lease."

In *Josey v. Commissioner*, 104 F. 2d 453 (C. A. 10), a similar situation was involved. The taxpayer bought a lease subject to a sublease for $50,000. Later the sublease was cancelled and taxpayer received $10,000. He claimed a loss on the theory that part of his $50,000 had been paid for the sublease and that the cost of the sublease was at least equal to the $10,000, but the Circuit Court of Appeals at page 455 said:

> "The cost to Josey of the lease, subject to the sublease, was $50,000. Assuming some part of that amount was paid for the sublease obligation, the record does not show that any attempt was made by Josey to establish what part of the $50,000 was paid for such contractual obligation."

In the case at bar, the fact that the value of the land before and after the casualty is measured by its income producing power does not mean that the taxpayer in claiming a casualty loss, is claiming a deduction for loss of prospective income. It is claiming a loss of present capital, for which it has a cost, and not claiming a loss of potential income for which it would have no cost. The value of the use of the land was shown as an evidential factor in determining the loss, and not as an independent basis for a loss.

This distinction is well established by the cases dealing with the receipt of damages to goodwill or business. An example is found in the decision of *Farmers and Merchants Bank of Catlettsburg*, 59 F. 2d 912 (C. A. 6). There the bank received a payment in settlement of a suit against the Federal Reserve System for interfering with its business and for injury to its goodwill. The court held that the amount received by the taxpayer was not income but a return of capital. The court, page 913, said:

> "We think that the gravamen of petitioner's action against the Reserve Bank was the injury inflicted to its banking business generally, and that the true measure of damages was compensation to be determined by ascertaining how much less valuable its business was by reason of wrongful acts of the Reserve Bank * * * Injury to its business of course means injury to its financial standing, credit, reputation, goodwill, capital, and other possible elements. Profits were one of the chief indications of the worth of the business; but the usual *earnings* before the injury, as compared with those afterward, *were only an evidential factor in determining actual loss and not an independent basis for recovery.*" (Emphasis added.)

In the case at bar, petitioner showed its earnings and rental value of the property before the flood and the complete lack of them afterwards, not as an independent basis for a deduction of potential income, but to show the shrinkage which occurred in the value of its property.

This same distinction was recognized in *Raytheon Production Corporation v. Commissioner*, 144 F. 2d

110 (C. A. 1). There the taxpayer sued RCA for damages caused by violation by RCA of antitrust laws. Money was received in settlement of the action and the court in the tax case held it was a return of capital invested in the goodwill. The court, page 113, said:

> "Where the suit is not to recover lost profits but is for injury to goodwill, the recovery represents return of capital and, with certain limitations to be set forth below, is not taxable."

The court further said at page 113:

> "The allegations and evidence as to the amount of profits were necessary in order to establish the value of the goodwill and business since that is derived by capitalization of the profits."

The court below erroneously concluded that petitioner was trying to take a deduction for loss of profits, whereas it was endeavoring to establish a present loss of capital invested in its farming lands caused by the flood injury to those lands.

Under Section 117(j) of the Internal Revenue Code of 1939, petitioner's loss is an ordinary loss, and not a capital loss, as miscalled by the Court below.

Conclusion.

For the reasons stated above, it is respectfully submitted that the judgment of the United States Court of Appeals for the Ninth Circuit should be reversed in its holding that:

1. There was no actual loss of present capital in the years claimed when the farming lands were inundated and rendered useless for a substantial period.

2. The flood injury to the lands did not constitute a closed and completed transaction.

3. No loss was deductible.

MELVIN D. WILSON,

Counsel for Petitioner.

APPENDIX.

Opinion of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals for the Ninth Circuit.

J. G. Boswell Company and J. G. Boswell Company, (Successor by merger to Tulare Lake Land Company) Petitioner, vs. Commissioner of Internal Revenue, Respondent. No. 17,140. April 17, 1962.

Petition to Review a Decision of the Tax Court of the United States.

Before: Chambers, Stephens and Hamlin, Circuit Judges.

By: Stephens, Circuit Judge.

In the spring of 1952, the Tulare Lake Basin was inundated by a snow-melt runoff flood. Petitioner claimed that it had sustained a loss in the amount of $1,695,619.06 by reason of this flood upon its land. In 1956, the Commissioner of Internal Revenue disallowed the loss deduction claimed, and assessed deficiencies accordingly. Petitioner sought relief in the Tax Court which held that petitioner was not entitled to deduct the alleged loss and confirmed the deficiencies asserted by the Commissioner.

This is a petition to review the Tax Court decision. 34 T. C. 539 (1960). The fundamental question presented is whether, as a result of the flood, the petitioner, J. G. Boswell Company, has sustained a loss within the meaning of Section 23(f) of the Internal Revenue Code of 1939 during the fiscal years ended June 30, 1952 and March 31, 1953.

Petitioner measures the claimed loss as being the alleged difference between the estimated fair market value of the land before the flood and the estimated value on June 30, 1952, when the flood-waters stood at their greatest depth on the land. The amounts claimed in petitioner's returns are either these alleged differences in value or the adjusted basis of the several parcels, whichever is the lesser amount. The injury causing the loss is alleged to consist of the following elements:

(1) Petitioner would lose the use of its lands for an indefinite period of time.

(2) The flood physically injured the petitioner's lands.

(3) The flood permanently added salts to the soil which would shorten its useful life for farming purposes.

(4) The "cotton history" of the land would be reduced since no cotton could be grown while the waters stood on the land.

The material facts found by the Tax Court may be summarized substantially as follows:

Petitioner, J. G. Boswell Company, is a California corporation, and is the successor by merger in 1957, of the Tulare Lake Land Company and the J. G. Boswell Company. The predecessor companies both owned land in the basin which was inundated by the flood. Because they had different fiscal years at the time of the flood, the loss deductions claimed appear in two separate tax periods. During the taxable years in question the petitioner was engaged in the operation of farms in Kings County, California, an area commonly known as the Tulare Lake Basin.

The basin is a reclaimed lake bed and is the natural repository for the waters of several mountain-snow run-off streams which flow into the basin.

Since the lowest natural outlet is nearly thirty feet above the floor of the basin, the flooding waters settle and in time sink into the soil, evaporate, or are removed by pumping. Thus it is not unusual for the water to remain many weeks before it is entirely removed, preventing the normal use of the land.

Approximately four feet below the surface is a hard clay pan which, for all practical purposes, is impervious to water. As a result, the soil above the pan has accumulated a high content of salt deposits carried in by the successive floods and irrigation waters. This accumulated salt water rests directly on the pan, and is known as the "perched water table."

The uncontrolled presence of salt tends to inhibit and may even prevent the growth of crops. Successful farming is possible, however, through a combination of leaching and other farming techniques such as deep plowing, mulching, and rotation of crops. (Leaching is the process of washing the salt deposits below the root zone by the proper application of irrigation waters.)

Although it was found that the flood water which came on the land in 1952 contained on the average at least 200 pounds of salt per acre-foot of water, there was no evidence as to the salt content of the soil at the time of the flood or immediately after the lands had been de-watered.

The levees were breached in the spring of 1952, and about June 30, 1952, when the flood reached its crest, the land in question was covered with 12 to 15 feet of

water. Pumping of the flood waters off one of the parcels was completed as early as February 23, 1953. By September 22, 1953, all of the remaining parcels had been pumped dry. The action of the flood waters caused breaks in the levees, washed the soil around, and deposited silt in the drainage and irrigation ditches. The land was left in an uneven and rough condition.

To rectify the damage done by the flood the petitioner was required to repair and level the land, rebuild the levees, and clean out the silt deposited in drainage and irrigation ditches. The costs of making such repairs were deducted on the petitioner's returns in the years incurred as ordinary and necessary business expenses. As soon as the land was de-watered and repaired, the soil was prepared for farming, crops were planted, and normal operation of the farms was resumed. The cost of this rehabilitation was also deducted by petitioner as ordinary and necessary business expense. Production on most of the land equaled or exceeded the pre-flood output.

The Tax Court found that the Federal Government had imposed cotton allotments or acreage limitations in 1950, and 1954, and the years following. In 1954, the limitation was imposed on a crop land basis, a system of computation which has no relationship to the number of acres previously planted to cotton. In 1950, and again in 1955, the limitation was imposed on a history basis, a system of computation which is based on the number of acres of cotton grown in the immediately preceding three years. Thus, in 1955, the petitioner's cotton allotment was restricted because of its lack of "cotton history" in the years of the flood. But in 1951, 1952, and 1953, during the tax years here involved, the

government did not restrict the growing of cotton on petitioner's lands.

In denying the petitioner's alleged loss, the Tax Court correctly set forth the requirements for capital loss deduction under Section 23(f) of the Code as follows:

> ". . . (1) There must be an actual loss; (2) the 'person' claiming the loss must sustain it; (3) the loss must be evidenced by a closed and completed transaction; (4) the loss must be fixed by an identifiable event; and (5) the loss must be sustained in the year claimed as a deduction.".

These requirements are based on Regulation 111, §29.23(e)-1 of the 1939 Code, which has been in effect for many years and has consistently required the elments listed above. Boehm v. Commissioner, 326 U. S. 287, 291 (1945). Although this regulation applies to losses by individuals, it is also applied to losses by corporations as provided by Regulation 111, §29.23(f)-1. Since these regulations have been "long continued without substantial change, applying to unamended or substantially re-enacted statutes," they may be deemed to have received congressional approval and thus have the effect of law. Helvering v. Winmill, 305 U. S. 79, 83 (1938). The pertinent provisions of Regulation 118, which apply to the taxable years beginning after December 31, 1951, are substantially the same.

With regard to these requirements, the Tax Court correctly observed that the facts of this case do not require a consideration of items (2) and (4). The loss, if any, was clearly that of the petitioner. And, as noted below, the flood constituted an identifiable event fixing the *onset* of the alleged damage, if any. We shall, then,

examine the elements of loss alleged by petitioner in light of the remaining requirements, items (1), (3), and (5).

Petitioner alleges as the first element of its loss the fact that, as of June 30, 1952, it would be unable to use the property for farming as long as it remained under water. This fact, it is contended, constituted an "absolute and final and non-recoverable and non-reversible" impairment to the value of the land which entitled petitioner to a capital loss deduction. In support of this contention petitioner cites a number of cases for the proposition that "the value of property is in the use to which it can be put." See United States v. White Dental Mfg. Co., 274 U. S. 398 (1926); W. K. Stowers v. United States, 169 Fed. Supp. 246 (S. D. Miss. 1958); United States v. Causby, 328 U. S. 256 (1945); Portsmouth Harbor Land and Hotel Co. v. United States, 260 U. S. 327 (1922).

We agree with the general proposition as cited from these authorities, but we think that the conclusions drawn therefrom by the petitioner in this case are not well founded. The value of this farm land is a reflection of its ability to produce income. If the property is standing under water, it is clear that the ability to produce income by growing cotton has been effectively interrupted. It is this impaired ability to produce income which petitioner cloaks in the phrase "impairment to the prospective use of the land" in order to take advantage of the language of the cases cited *supra*.

But calling the loss of potential income a loss of use of the property does not, in our view, serve to bring petitioner's case within the rule established by these authorities. In each of those cases the impaired useful-

ness of the property was for all practical purposes permanent in nature. The finality of the lost use was enough to convince the courts in those cases that the transactions amounted to a loss of the property itself. In other words, the transaction had closed and the loss in value had in fact been realized.

In the instant case, however, the facts do not support such a conclusion. Here, the basin had a history of periodic flooding, in which normal farming operations were resumed shortly after the lands had been dewatered. That petitioner had the same expectation after this flood is shown by the fact that it bought a parcel of land in 1946, which was under water at the time of purchase, de-watered the land, and began to farm it the following year.

As of June 30, 1952, petitioner had not sold or otherwise disposed of his interest in the capital asset here involved. What then is the nature of the loss petitioner claims to have sustained? In our view, the substance of petitioner's claim is that it would be deprived of the income produced by its farms during the temporary presence of the flood waters on the land. The Tax Court found, and petitioner in fact admits, that the presence of the flood waters would be only temporary. Such a short-term interruption in the use of the property is not in our view tantamount to a loss of the property itself.

That such a claim cannot be the basis for a Section 23(f) loss deduction is clearly established by Hort v. Commissioner, 313 U. S. 28 (1941). In that case the Supreme Court set forth the rule that a loss of potential income is not a deductible loss within the meaning of

the capital loss provisions. We think the rule of the Hort case to be controlling here, and we are not persuaded by petitioner's efforts to distinguish it from the instant case. The policy underlying the Hort rule may require its application in many fact situations. Where, as here, petitioner's claim amounts to nothing more than a temporary loss of potential income from the property, no loss deduction can be allowed.

Petitioner alleges as the second element of its loss the physical injury inflicted upon its land by the flooding water. The Tax Court, however, found that these injuries had been repaired and that the land had been rehabilitated for farming use. It found that the out-of-pocket costs incurred to make these repairs were deducted by petitioner as ordinary and necessary business expenses. These deductions were stipulated by the parties to have been properly deducted. By now claiming these expenses as a loss, petitioner seeks to reinforce its allegations as to the other, more speculative, elements of loss sustained. We agree with the Tax Court's conclusion that "petitioner's claim for the loss is not advanced by this contention." 34 T. C. 539, 545.

Petitioner argues further, however, that if we hold these expenses are now properly claimed as a loss, the Commissioner may invoke the relief provisions if such a decision were made. But the availability of this relief does not serve to support the merits of petitioner's claim that such expenses should now be regarded as capital loss.

Petitioner alleges as the third element of loss the addition of salts to the soil which, it is claimed, shortened the useful life of the land for farming purposes. The

Tax Court found this contention to be without merit. We think that substantial evidence exists in the record to support this conclusion.

First, petitioner did not present any evidence to show the actual amount of salt added to the soil by the 1952 flood. The only evidence on this point shows an increase in the salt concentration on one particular parcel between the years 1948 and 1958. Such data provides the trier of fact with no reliable inference as to the salt increase brought about by the 1952 flood. As the Tax Court pointed out, other floods and irrigation waters, both before and after the 1952 flood have also added salt deposits to the soil.

Second, petitioner also contends that the salt deposits added by the 1952 flood constituted permanent damage to its land. This it is urged, is supported by the opinion below.

We think that a careful reading of the Tax Court's opinion indicates just the contrary. The court below concludes that increased salt deposits from the 1952 flood would not, per se, shorten the useful life of the land. 34 T. C. 539, 549.

In support of this conclusion the Tax Court relies upon the fact that modern farming techniques to control the salt content of the soil have been successfully used on the farms in this basin. In fact many areas formerly unuseable have been so treated by these methods and are now successfully farmed. Such techniques were used by the petitioner in this case to the end that the land was shortly returned to farming use and has produced as much or more than before the 1952 flood. We note that the costs incurred in rehabilitating the soil from these salt deposits are generally deductible

as ordinary and necessary business expenses, and were so deducted by the petitioner after the 1952 flood.

On the basis of these facts the Tax Court concluded that a claim of permanent damage to the useful life of the land was too speculative to justify a capital loss deduction in the taxable years in question. We agree. Petitioner has received the benefit of a tax deduction for the out-of-pocket expenses incurred to return the land to productive use. The alleged capital loss was properly disallowed.

Petitioner alleges as the fourth element of loss the reduction in the "cotton history" caused by its inability to grow cotton while flood waters stood on the land. In our view this contention is also without merit. For the taxable years in question this claim is at best, speculative.

Petitioner's claim of loss rests on the assumption that the government will impose, in the years immediately after the flood, the same type of crop limitation as it has in the past. That this assumption cannot support a claim for a Section 23(f) loss deduction is made clear by the rule in Lucas v. American Code Company, 28 U. S. 445 (1929). That case requires that where the loss has not been realized by sale or other disposition, it must be "reasonably certain in fact and ascertainable in amount" to be deductible as a capital loss.

Neither of these tests is met in this case. The speculative nature of the claim is made clear by the fact

that crop limitations on a "cotton history" basis were imposed in 1950 and not again until 1955. Also by the fact that the limitations imposed in 1954 had no relation to the history of cotton grown on the land. In other words, as of the taxable years in question, petitioner was not reasonably certain in fact either when the growth of cotton would again be restricted or if the history of cotton grown would be a basis for that restriction. The year in which such controls were again imposed would also have an effect upon the amount of the loss to be claimed, a factor which petitioner failed to consider. Such speculation cannot, in our view, be the basis for a Section 23 (f) capital loss deduction. In view of our determination of this claim we do not reach the question (not raised on brief) as to whether a "cotton history" is an element of property which can come within the capital loss provisions in a year when such a crop restriction is in fact imposed.

Having thus concluded that each of the elements of loss alleged by petitioner is not properly the basis of a Section 23 (f) capital loss deduction, the deficiencies asserted by the Commissioner must be sustained.

The decision of the Tax Court is affirmed.

(Endorsed) Opinion Filed April 17, 1962.

Frank H. Schmid, Clerk.

Judgment.

United States Court of Appeals for the Ninth Circuit.

J. G. Boswell Company and J. G. Boswell Company (Successor by merger to Tulare Lake Land Company) Petitioner vs. Commissioner of Internal Revenue, Respondent.

Upon Petition to Review a Decision of The Tax Court of the United States.

This Cause came on to be heard on the Transcript of the Record from The Tax Court of the United States, and was duly submitted.

On Consideration Whereof, it is now here ordered and adjudged by this Court, that the ..... Decision of the said Tax Court of the United States in this Cause be, and hereby is affirmed.

Filed and entered April 17, 1962.